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REGULATORY FRAMEWORK FOR CREATION AND DEVELOPMENT OF CROWDFUNDING PLATFORMS

The article presents theoretical approaches to the definition of crowdfunding and describes its types. The practice of crowdfunding platforms in developed countries has been analyzed. Approaches to creation and regulation of work of crowdfunding platforms in Ukraine have been offered.

Keywords: *crowdfunding, financial innovations, crowdfunding platform, financial market.*

Колінець Леся, Братко Олександра, Бучинська Тетяна. Нормативно-правова база для створення та розвитку краудфандингових платформ.

У статті розкрито теоретичні підходи до визначення краудфандингу та охарактеризовано його види. Проаналізовано практику функціонування краудфандингових платформ в розвинених країнах світу. Запропоновано підходи до створення та врегулювання роботи краудфандингових платформ в Україні.

Ключові слова: *краудфандинг, фінансові інновації, краудфандингова платформа, фінансовий ринок.*

Relevance of research topic. Financial innovations play an important role in ensuring the sustainable development of the countries, integration entities and the

global economy in general. Although they were not originally intended to do so, well-chosen tools and regulatory frameworks allow them to be transformational changes in the global financial market. Thus, crowdfunding is one of the technological innovations in financial services in the world.

Crowdfunding platforms may perform functions similar to banking in the future, but there are theoretical reasons to believe that platform-based brokerage may be more stable than bank brokerage. The success of these platforms depends on their ability to address moral hazard issues and overcome significant entry barriers associated with economies of scale and the risks associated with over-reliance on the volume of funds involved.

Formulation of the problem. The formation of a regulatory basis that is able to determine the effective framework for the operation of crowdfunding platforms is important at this stage. This will strengthen their influence on the financial system of the countries and promote the development of small and medium-sized enterprises.

Based on the above, we can formulate the following goals of this research:

- 1) to reveal the theoretical foundations of crowdfunding;
- 2) to analyze the practice of operation of crowdfunding platforms abroad;
- 3) to offer the approaches to creation and regulation of work of crowdfunding platforms in Ukraine.

Analysis of recent researches and publications. A number of scientific works has been devoted to the problems of formation and development of crowdfunding in the world. Thus, N. Vulkan, T. Astebro (Vulkan et al, 2016) and D. Schweitzer, S. Johan and K. Günther (2017) describe the size of the crowdfunding market, its growth and geographical location. A. Agrawal, K. Catalini and others show in their research that syndicates help well-informed lead investors in equity crowdfunding extend their knowledge to a less well-informed crowd that is consequently willing to invest in a company (Agrawal et al, 2016).

The existing scientific findings have not fully reflected the regulatory framework for the use of financial innovation and, in particular, crowdfunding. This is what made the research relevant.

Presenting main material. The importance of innovation for financial and economic development is undeniable. According to the standard approach, innovation occurs when the new ideas, solutions and tools are introduced to change and improve the economic condition of the business entity.

Initially, the term «innovation» was used to refer to changes in technological solutions that resulted in new combinations of means of production, profitability was achieved that exceeded the level of average indicators, thus enhancing the dynamics of economic development as a whole.

One of the innovative financial instruments is crowdfunding. It is derived from the phenomenon of crowdsourcing. In turn, the term «crowdsourcing» consists of

«crowd» and «outsourcing», which indicates outsourcing of specific functions to a group of outsiders. The concept is based on the idea of «wisdom of the crowd».

Traditional project financing requires the involvement of a small number of investors who are willing to invest large sums of money. In turn, crowdfunding is a way to raise money for a project using the Internet by appealing to a large number of people to invest small sums of money.

There are different types of crowdfunding:

1. Real Estate Crowdfunding – individuals or institutional funders provide equity or subordinated debt financing for real estate.

2. Equity-based Crowdfunding – individuals or institutional funders purchase equity issued by a company.

3. Revenue Sharing/Profit Sharing Crowdfunding – individuals or institutions purchase securities from a company, such as shares or bonds, and share in the profits or royalties of the business.

4. Reward-based Crowdfunding – backers provide funding to individuals, projects or companies in exchange for non-monetary rewards or products.

5. Donation-based Crowdfunding – donors provide funding to individuals, projects or companies based on philanthropic or civic motivations with no expectation of monetary or material return (Ziegler, Johanson et al, 2019).

The market for alternative financial instruments, including crowdfunding, is developing at a rapid pace.

Thus, on the American continent Real Estate Crowdfunding increased by 128% to \$1.8 billion in 2017 from \$821 million in 2016. The model accounted for 4.2% of the total market in 2017 and grew by 128% annually.

Reward-based Crowdfunding declined 26% to \$440.4 million in 2017 from the \$596 million recorded in 2016. Overall, it accounted for 1.0% of the total volume in 2016.

This model saw a decrease of 13%, from \$339.2 million in 2016 to \$293.5 million in 2017. Donation-based Crowdfunding has seen an annual growth rate of 40% over the past three years. It represented 0.7% of the total market volume in 2017.

Equity-based Crowdfunding accounted for \$260.9 million in 2017, down 54% from \$569.5 million in 2016. It represented 0.6% of the entire Americas market.

Revenue-sharing/Profit-sharing Crowdfunding's volume in 2017 was \$32.9 million, a 16% increase from 2016's \$28.4 million. Overall, Revenue-sharing/Profit-sharing Crowdfunding had a 0.1% share of the total market volume (Ziegler, Johanson et al, 2019).

The total European online alternative finance market (including the UK) grew by 36% to reach €10,436m in 2017. The United Kingdom is still the largest individual alternative finance market, albeit with a declining market share from 73% in 2016 to 68% in 2017. Excluding the UK from overall volume, the European online alternative finance industry grew 63% from €2,063m to €3,369m in 2017. This growth is slower

than in previous years, as in 2016 the market grew 102%. Between 2013 and 2017, the average annual growth rate for Europe has been 80%.

In 2017, perceptions of risk were split amongst model types, with no one clear risk factor for all platforms. For P2P Consumer Lending and P2P Business Lending, ‘Collapse due to Malpractice’ was the highest risk – ranked between high and very high by 55% and 34% of model types, respectively. ‘Campaign Fraud’ was perceived to be the highest risk by Invoice Trading (73% high to very high risk), Debt-based Securities (29%), and Donation-based Crowdfunding (38%) platforms. The risk of a «Cyber-security Breach» was perceived as the highest risk for Equity-based Crowdfunding (40% high to very high risk), and Rewardbased Crowdfunding (44%). «Changes to Regulation» was seen by four model types as the second highest risk, particularly Equity-based Crowdfunding (37%), P2P Consumer Lending (30%), Donation-based Crowdfunding (30%) and Reward-based Crowdfunding (26%).

As regulatory regimes across Europe continue to develop, so to do the perceptions of platforms on the adequacy of these regulations. In general, while overall views are still divided, it appears that the level of approval has been increasing. A majority of platforms operating P2P Business Lending (71%), Debt-based Securities (67%), P2P Consumer Lending (63%), Real Estate Crowdfunding (56%) and P2P Property Lending (50%) viewed current regulations to be adequate and appropriate. In contrast, a large percentage of Equitybased Crowdfunding (53%), Rewardbased Crowdfunding (43%), and P2P Property Lending (42%) platforms viewed regulation to be excessive and too strict.

Real Estate Crowdfunding grew 136%, increasing from €109m in 2016 to €259m in 2017, generating the fourth largest volume in Europe. This model recorded thirty-nine entries from 35 distinct firms. Only three firms had operations in more than one country.

Despite the impressive growth reported for this model, volumes of Real Estate Crowdfunding may still be underestimated, as some Equity-based Crowdfunding platforms don’t distinguish between Real Estate Crowdfunding campaigns and Equitybased Crowd.

Equity-based Crowdfunding’s total volume decreased slightly, reducing its share of the market from 11% in 2016 to 6% in 2017.

An interesting development, countering trends in other models, was the significant decrease in Reward-based Crowdfunding. Total volumes fell 17% between 2016 and 2017 and moved it from being the fifth largest model in 2016, to the sixth in 2017 (Ziegler, Shneor et al, 2019).

Legislative regulation of the use of alternative financial instruments, including crowdfunding, is now an important priority for most states. Thus, national legislation on alternative financing is in place in EU countries, but there is no single European Directive to regulate this. The European Commission is taking steps to position Europe as a more attractive place to set up crowdfunding companies. The Commission

has proposed a draft regulation that will allow crowdfunding platforms to gain access to clients across the EU. The EU Executive Body has also developed an action plan aimed at the rapid development of the latest technologies. The current problem with cash payments in Europe is that there are no crowdfunding laws, which means that start-ups in this area start at national rules that often slow down their development. New EU rules will make markets safer and more accessible for new companies.

There is also a gap in Ukraine in the legislative framework for regulating the circulation of alternative financial instruments, in particular for crowdfunding and crowdfunding. This area is already regulated in most developed countries of the world, including the USA, France, Austria, Belgium and others. However, there is no legislation in Ukraine that protects the rights of investors of alternative financial instruments and regulates the issue amounts of such instruments, the maximum amount of purchase by an individual investor, etc.

These issues should be regulated in Ukraine as well, so that platforms can properly perform their social function, taking into account risks, consumer protection and ensuring the stability of the financial system. Alternative financial platforms may need special secondary rules that, depending on each country's legal system, will empower one or the other financial supervisory authorities (when there is no single supervision) (Kolinets, 2018).

Therefore, it is necessary to break down the following aspects in legislative and regulatory acts:

- To identify clearly supervisory and control entities: It is recommended to identify current and, if possible, future participants. This means defining concepts such as platform, investors and project owners. Defining activity as such should also mean changing the regulatory paradigm, but it is mandatory. In addition, identifying investors is important in terms of whether or not to choose the categories of accredited and non-accredited investors. The regulatory consequences of a regime will affect the type of investor protection that regulation should include.

- Authorization and Supervision Mode: clear principles for the process that empowers a government authority to an economic or financial authority. It is necessary to identify a single manager responsible for the activity. Specific and proportionate requirements and specific terms for registration and licensing must also be established. The platform must be operational or close to the operating system. An authorization procedure and a list of requirements should be developed.

- Minimum Capital Requirement: It is recommended that a financial supervisor be established to oversee the minimum capital requirements for platforms to support their operational activities. The ratio criterion must be determined by certain principles.

– Due Diligence: harmonious principles in accordance with international standards for combating money laundering and terrorist financing, including responsibility for platforms, investors and buyers.

– Business behavior: principles of processing and sending information to authorities, information required for financial users of the platform, information directed to investors about the risks of the platform, collection.

– Protection and independence of customer resources. The regulation should include principles for allocating resources from customers and platforms, and segregation mechanisms such as deposit accounts.

– Consumer Financial Protection: Principles of provisions that can be applied to protect investors and other financial consumers, depending on the segment. Clear definition of authority among consumer protection authorities.

– Supervision, monitoring and sanction regimes: principles for providing information to authorities, such as financial statements. Also, the principles of determining the powers of inspection, financial violations and modes of crime and sanctions (fines, other administrative procedures).

As it has been noted earlier, secondary regulation plays an important role in making recommendations based on these principles. As the development of financial technologies is so dynamic so adaptation to regulators and supervisors is a must. The rules must be adapted to the local ecosystem, but the possibility of regional convergence in regulation must also be considered.

Based on an analysis of EU law and the principles outlined above, we propose to limit the maximum amount without a prospectus for a crowdfunding equivalent to \$ 300,000. USA. Also limit the maximum amount of sales per investor to \$ 1,000. With an issue volume of \$ 100,000 to \$ 300,000. USA; however, remove any emission limit not exceeding \$ 100,000. USA. Crowd Investments should be conducted on an online platform: a website that conducts brokerage transactions between issuers and investors. The operator of the Internet platform may be a natural or legal person operating the Internet platform. He has the right to inform about alternative financial instruments between investors and issuers. Internet platform operators are required to publish their latest annual financial statements. Operators of the Internet platform are prohibited from acting as their own issuer on their Internet platform. Being an investor on your own online platform is only allowed if it is a small investment that is intended only to facilitate the flow of information between issuers and investors. In turn, issuers should be required to provide simplified documentation to investors, but not subject to approval by the securities regulator. This will strengthen Ukraine's position as a country conducive to investment and financial innovation.

Conclusion. The current financial system is characterized by high rates of innovation that can occur in any of its elements – markets, institutions, instruments and regulation. It can be expected that financial innovation will fundamentally change

the financial sector over time, questioning the role of banks as financial intermediaries. Many of the technological innovations in the financial sector (fintech innovation), such as crowdfunding, do not seem to have a direct impact on monetary policy. However, they can affect financial stability and therefore justify the need for meticulous monitoring, which can be an important and interesting subject for further research, both theoretical and empirical.

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